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AMERICA'S HOT YOUNG SCIENTISTS

These men and women give the U.S. an edge in the race for global advantage

Top astronomer Alan Dressler peers into the origins of the cosmos.

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OCTOBER 8, 1990

VOL. 122, NO. 9

FORTUNE

ABOVE: Physicist Mark Reed of Yale University, photographed by Louis Psihoyos (Matrix).

COVER: Psihoyos also shot this picture of astronomer Alan Dressler.

"Most people are awed by the size of the universe and our being so small. My view is completely opposite. The mind is the most complex thing we know of." PAGE 56

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"The convertibility of the ruble is my highest priority."

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"The economy is like the stock market. The longer you go without a correction, the bigger the blowout when it comes."

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"If maintenance gets as intolerable as it has at Eastern, [the airline industry] can expect criminal charges."

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"He's an honest-to-God 19th-century businessman, unencumbered by ideology."

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"We don't see failures sufficient to imperil our fund. But that obviously depends on the economic environment."

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"The competitive arena has been more intense than anyone could have imagined."

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EDITOR'S DESK

Left: cover story reporter Moore, editor Petre, writer Bylinsky. Top: picture researcher Green and designer Hoffman. Bottom: photographer Psihoyos with a Chinese finger puzzle used to explain a scientist's discovery.

AMERICA'S scientists are among its greatest competitive strengths. This issue's cover story introduces a new generation—12 young researchers who have made important breakthroughs in fields from computer languages to robotics to molecular biology. Their work will change our lives, and perhaps lead to some entirely new industries. The story follows in the steps of one we published in June 1954, when we identified 20 promising young scientists. Five later won Nobel Prizes.

Chances are some of these will too. The 12 were chosen from more than 100 candidates by Gene Bylinsky, a member of our board of editors, and associate editor Alicia Moore. Bylinsky, who has won 17 awards since 1966 for his scientific reporting at FORTUNE, knows how to pick winners early. He spotted major advances like the integrated circuit well before the rest of the press. Moore, a biologist by education, specializes in science and technology reporting, as does Peter Petre, who edited the story.

RICHARD A. WHITMORE

Louis Psihoyos's photographs spectacularly augment Bylinsky's text. Seeking more than conventional portraits, he used a technique that is a standard tool in science fiction movies but rarely employed in still photography. It is called front-screen projection, and it involves shooting through a large glass screen to show the scientist surrounded by computer models or photographs of the project on which he or she is working. It also takes effort: Psihoyos traveled for three weeks with more than 800 pounds of equipment in 18 bags.

He found the scientists significantly less vain than his usual portrait subjects: "Most businessmen say things like 'Don't get my paunch,' but these people said things like 'I'm blocking an ion there, can you put me over in this part of the picture?' They were more interested in their work than their hair."

The story itself was technically innovative for us—the first big article designed entirely on our new computerized layout system. Associate art director Joan Hoffman operated the computer; picture researcher Chris Green edited Psihoyos's images. They work together often on technology stories. Three years ago they formalized the collaboration—by getting married.

Marshall Loeb
MANAGING EDITOR

FORTUNE (ISSN 0015-8259). Published biweekly, with three issues in October, by The Time Inc. Magazine Company. Principal office: Time & Life Building, Rockefeller Center, New York, NY 10020-1393. Reginald K. Brack Jr., President; Joseph A. Ripp, Treasurer; Harry M. Johnston, Secretary. Subscriptions: U.S., possessions: one year (27 issues) $49.95; Canada: one year (27 issues) $54.00. Second-class postage paid at New York, NY, and at additional mailing offices. Authorized as second-class mail by the Post Office Dept., Ottawa, Canada, and for payment of postage in cash. Member, Audit Bureau of Circulations. POSTMASTER: Send address changes to FORTUNE, P.O. Box 30604, Tampa, Fla. 33630-0604. Customer inquiries: FORTUNE, P.O. Box 60001, Tampa, Fla. 33660-0001. Phone: 1-800-621-8000. © 1990 The Time Inc. Magazine Company. All rights reserved. FORTUNE is a registered mark of The Time Inc. Magazine Company. **For subscription queries, call Customer Service at 1-800-621-8000.**

THE BOSSES SEE A RECESSION SOON

Sharply reversing earlier views, America's leading chief executives overwhelmingly believe an economic downturn is here or imminent. They're not so bearish on stocks. ■ *by Jaclyn Fierman*

IF THINKING makes it so, then the phantom recession of 1990 could well turn into the real thing. "No question about it," says James Dresher, CEO of air-conditioning manufacturer York International Corp. "Anyone who doesn't think we're in a recession isn't facing reality." But by FORTUNE's numbers-based reality test, the U.S. is *not* in a recession. Nor, according to this magazine's economic forecast, will it be in the coming year (see Fortune Forecast). But chief executives seem convinced otherwise. As Western Publishing Group s Richard Bernstein sees it, recession is not a question of numbers but "a state of mind."

Q A Because of recession concerns, has your company . . .

	Yes	No	Not sure/ doesn't apply
Cut capital spending?	30%	65%	5%
Reduced its work force?	30%	66%	4%
Cut inventories?	26%	52%	22%
Reduced orders to suppliers?	24%	58%	18%
Done any of the above?	47%	—	—

The latest FORTUNE 500 CEO Poll found that 71% of respondents believe the nation is in a recession or will be in the next 12 months. Surprisingly, their predictions for the stock market are considerably less gloomy: On the theory that the market has already absorbed the idea of a short-lived recession, half expect the Dow to be somewhere between 2500 and 3000 a year from now; most of the rest predict it will be between 2000 and 2500, with a few seeing it above 3000. The independent opinion research firm Clark Martire & Bartolomeo spoke by telephone with 221 chief executives of FORTUNE 500 and Service 500 companies between August 29 and September 6.

REPORTER ASSOCIATE *Alicia Hills Moore*

Just a year ago corporate chieftains had a much more cheerful take on things. When polled last September, only 38% of CEOs said they anticipated a recession in the next 12 months. In January 1989 a mere 16% saw recession in the offing.

It isn't hard to understand why so many chief executives have changed their minds. No one disputes that the economy has slowed considerably in the past year or so. Inevitably some companies do better than the average while others do worse, and overall growth of real GNP is now so tepid—only about 1.5% a year—that some of the laggards may be contracting. In addition, eight years of economic expansion may have lowered executives' tolerance for the odd reversal. A marked slowdown, even if it does not exterminate growth, may seem a lot more alarming today than it would have a decade ago.

The new tune—make that dirge—of CEOs varies in pitch depending on where they live and what trade they ply. Among the most dispirited is William O'Brien, head of Hanover Insurance Co. in Worcester, Massachusetts. "I make my judgment on what I see in New England, not on what I read in the paper," he says. "The contraction of credit is enormous. And banks are asking for a hell of a lot more collateral on loans. We are in a recession here."

Surveying the economy from the deck of American President Cos., which makes shipping containers, CEO Bruce Seaton is only slightly less downcast than O'Brien. "Economists wouldn't agree with me, but from my vantage point we're in a mild recession," he says. "Consumption is off and our trade is off. There is a reduction of cargo flow from Asia to North America.

"In light of the economy, we're trying to reduce costs and increase our productivity. So we're investing in more efficient plants and equipment."

RICHARD BERNSTEIN
Western Publishing

We've been seeing it since last year."

Back in the heartland, in Muscatine, Iowa, Hon Industries' Stanley Howe speaks for the more sanguine minority: "I have trouble saying we're in a recession. Our state income tax collections are exceeding expectations. The Rust Belt has been unfairly maligned." As testimony to his opti-

Q A **Is the U.S. economy in recession or will one begin in the coming 12 months?**

Answered **Yes** in...

1990	Sept.	71%
1989	Sept.	38%
	Jan.	16%
1987	Nov.	17%
	Sept.	13%

☑ San Francisco Earthquake

☑ Hurricane Hugo

☑ USSR Gas Explosion

☑ Armenian Earthquake

☑ Hurricane Gilbert

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mism. Howe has ordered up four new plants for his office furniture business.

While most CEOs surveyed are in the grip of recession psychology, not all of these have started to manage accordingly. Just 30% have lowered capital spending, and about the same percentage have laid off employees. Even fewer, 26%, have shed inventory, and only 24% have cut down on orders to suppliers. Nonetheless, nearly half have taken at least one of these steps, actions that in the aggregate could increase the chance of recession.

"It's an absurdity to think that as a country we can live off borrowed money."

JOHN BRYAN
Sara Lee

John Bryan of Sara Lee Corp. this year will cut projected capital spending by 15%, or $100 million, though he has not bought into the recession scenario. "We're not there yet, but we're coming in for a landing, and I don't know how rough it will be," he says. "We're trying to prepare by paying more attention to cash flow, not just reported earnings." Dresher of York International has also begun to manage defensively. Believing a recession has already begun, he says that if it continues he'll cut inventories by as much as $40 million. And Forrest F. Stacy, CEO of Oglethorpe Power Corp. in Georgia, is nipping costs wherever possible. Example: He is trying to extend the life of company cars by more dutiful maintenance.

Q A Has "recession talk" played a role in determining companies' business plans?

Yes	87%
No	9%
Not Sure	4%

Chief executives who are not cutting back offer astute—if sometimes counterintuitive—explanations. John Woodhouse, CEO of Sysco Corp., a food distributor and marketer in Houston, says his company will probably *increase* capital spending over last year, even though he says there might well be a recession sometime in the next 12 months. "If you don't spend when times are still good," he says, "you may not be able to build up capacity again when you are trying to emerge from a recession."

Similarly, Western Publishing's Bernstein has raised capital spending to a new record this year despite his belief that a recession has already overtaken the commercial printing business. He explains, "In light of the economy, we're trying to reduce costs and increase our productivity. So we're investing in more efficient plants and equipment."

Regardless of how they're managing, most CEOs have definite ideas about how Washington could help keep the country out of recession. Fully 67% are singing the budget blues, calling for the government to narrow the deficit one way or another. In the near term, of course, that may not make much sense as an antirecession measure. Reducing the deficit probably means

"We've got a bunch of gluttons here. If it's not Saddam Hussein we're dealing with, it will be someone else."

WINSTON WALLIN
Medtronic

Q A

Where do you expect the Dow Jones industrial average to be in a year?

	Answered **Sept. 1990**	Answered **Sept. 1989**	Answered **Nov. 1987**
Over 3000	8%	0	0
2500-2999	50%	47%	7%
2000-2499	35%	44%	53%
1500-1999	3%	0	38%
Below 1500	0	6%	1%
Not sure	4%	3%	1%

raising taxes or cutting spending or both, and any combination would diminish the federal government's fiscal stimulus to the economy, slowing it even further. Some economists argue that cutting the capital gains tax, as President Bush advocates, would yield benefits without the bite, increasing tax revenues while spurring the economy. But enacting such a change will be politically tough, and at least some of the CEOs aren't thinking of it anyway. "Reduce spending," insists Geico's William Snyder. "When we're in a recession, reduce spending. When we're in an expansion, reduce spending. When we're level, reduce spending."

Easing the money supply is the rallying cry of 63%. Bernstein speaks for many: "Cutting interest rates would send a psychological message that the government is concerned and is doing something. That would make people feel better, and when they feel good, they spend."

Other quick fixes chief executives would like to see: an end to the crisis in the Middle East and an oil tax. Winston Wallin, CEO of Medtronic Inc., a medical equipment manufacturer in Minneapolis, believes that a "hefty" tax on gasoline and oil would ease U.S. dependence on foreign energy supplies and encourage the development of alternative sources. "We've got a bunch of gluttons here," he says. "If it's not Saddam Hussein we're dealing with, it will be someone else."

SHHHHH! That was the most poignant plea of the chief executives surveyed. If everyone, especially the media, would please be quiet and stop the incessant recession chatter, perhaps the economy would start to improve—or at least stay out of quicksand. "If we cry wolf on recession, we'll have one," says Jack Twyman, CEO of Super Foods Services Inc. in Ohio. "The food business is one of the last to be affected in a recession. But I'm concerned about all the rhetoric and the prophets of doom. We can talk ourselves into a recession."

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As though recession were our penance, some CEOs argue we should do nothing to forestall one. Among them is Jerry Pearlman of Zenith Electronics. "We must get the deficit under control," he says. "If reducing it means higher taxes and cutting spending and some recession, this may be the price we have to pay for living without restraints for so long."

Others maintain that even attempting to stop a recession would be futile: What goes up must come down, they say, and down the economy is coming. "When you fly so high, borrowing and fooling yourself as we did through the Eighties in the personal, corporate, and federal sectors, you have to expect to come down to the ground," says Sara Lee's Bryan. "For eight years we have lived well in this country but way above our means. Housing and art are outrageously inflated, and our standard of living is supported by enormous debt. It's an absurdity to think that as a country we can live off borrowed money."

A few executives, viewing recession as inevitable, would just as soon grit their teeth and be done with it. That's the view of Marion Sandler, president and CEO of Oakland's Golden West Financial Corp., one of the few bright spots in the savings and loan industry. "The economy is like the stock market," she says. "The longer you go without a correction, the bigger the blowout when it comes. We've had an eight-year expansion without a meaningful adjustment. That can't continue. Let's shake it out and get it over with." She expects a recession within a year and already sees the demand for money drying up. F

Q What one or two things should the federal government be doing to keep the nation out of recession?

A

Deal with the federal deficit/ balance the budget/reduce government spending	67%
Lower interest rates/ease the money supply	63%
Avoid new taxes	10%
Solve the Iraq problem	7%
Impose an oil tax	5%
Reduce government interference with business	4%
Encourage more research and development	1%

"We've had an eight-year expansion without a meaningful adjustment. That can't continue. Let's shake it out and get it over with."

MARION SANDLER
Golden West Financial

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WILL THE FDIC RUN OUT OF MONEY?

There's a good chance that it will. But by taking the right steps now, Washington can ensure that banks won't cost taxpayers anything like what the S&Ls have. ■ *by Brett Duval Fromson*

IS AN S&L-SIZE DISASTER brewing among America's commercial banks? With banks already failing at the highest rate since the Great Depression, both the Congressional Budget Office and the General Accounting Office have recently issued dire predictions. If the economy slows further, they say, a key line of defense—the Federal Deposit Insurance Corp., whose $13.2 billion insurance fund pays depositors when banks fail—could quickly run out of money. Says Dan Brumbaugh, a former research scholar at Stanford University, one of the few experts to predict the S&L debacle: "Make no mistake about it. We are in the incipient stages of the next crisis."

So far, however, the warning lights are flashing only yellow. Banking's worst problems are concentrated in ten states (see map on following page). Compared with the thrifts, banks have far more capital, a much more solid earnings base, and considerably better management. If the U.S. avoids a recession and if policymakers learn the right lessons from the S&L mess—admittedly no small assumptions—the tab that's ultimately handed to taxpayers because of bank failures could be held to a small fraction of the $150 billion thrift bailout bill.

No one denies that the industry faces hard times. "The U.S. banking system is under stress," says FDIC Chairman William Seidman. Three hundred fifty-four banks have reported annual losses every consecutive year since 1986. Among big money center banks, profits are so poor that some have been eating into capital just to cover dividend payments. Write-offs as a percent of

FDIC Chairman William Seidman, who often rides a bike to his office near the White House, looks considerably more fit than his insurance fund.

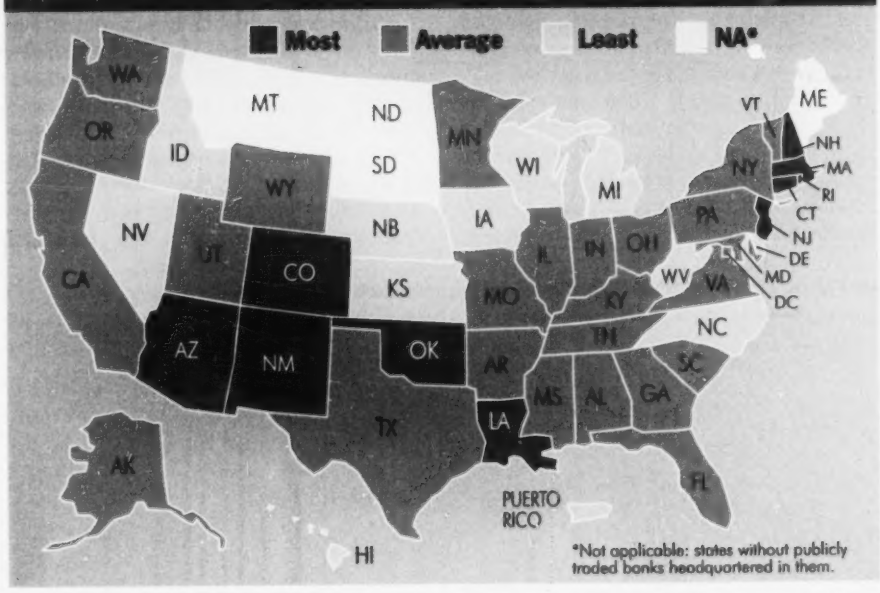
CHARLES ARCHAMBAULT

loans have risen from 0.84% four years ago to 1.16%—worrisome by historical standards. As for liquidity, banks depend more than ever on brokered deposits—an expensive and fickle source of funds, gathered together by stockbrokers and shunted off to whoever pays the highest yields. (Many now-defunct S&Ls were into the same game.)

The unhappy result: Since 1987, U.S. banks have been failing at the rate of 200 per year, vs. just ten a year in 1980. To make depositors whole, the FDIC's insurance fund shrunk by $5.1 billion in 1988 and 1989. In July, three months after saying that the FDIC would *not* lose money a third straight year, Chairman Seidman was forced to acknowledge that the agency would be out another $2 billion in 1990. Since then 20 more banks have gone bust, notably the National Bank of Washington, whose failure could by itself cost the FDIC more than $500 million.

WHICH STATES' BANKS ARE MOST TROUBLED

Based on the ratio of nonperforming loans to total assets of publicly traded banks headquartered in each state.



SOURCE: SNL SECURITIES

SMALL WONDER that in the last year the average price of the 50 largest publicly traded commercial banks has dropped more than 40%. Frets James Sidell, president of UST Corp., holding company for a profitable and well-capitalized New England bank: "This industry has one foot on a banana peel and the other in the grave." Recently Carole Berger, a respected analyst at the brokerage C.J. Lawrence, issued a report on high-risk lending at those same banks, with this headline: THE PLAGUE SPREADS. ANALYSTS FEAR EPIDEMIC.

Bubonic banking has been incubating for more than a decade. It intensified in 1980, when the government removed longstanding ceilings on the interest rates banks and thrifts could pay depositors. With the demise of Regulation Q, as it was known, these institutions' cost of money soared as they were forced to bid for deposits against newly arrived money market funds.

That change, in turn, spawned what Marc Perkins, chairman of the Tampa investment bank Perkins Smith Inc., calls "the compulsion to lend" among bankers. Says Perkins: "The way it used to work was that toward the end of a credit cycle, the wise old bank president would go downstairs to his loan department and say, 'Fellas, don't make any more loans. Just buy T-bills, and instead of earning 4%, we will earn 2%.' But after Reg Q went the way of the dodo bird, the loan officer told the bank president, 'We can't do that because the yield on T-bills is below what we're paying for deposits.' So the president says, 'Well, forget I was here. You better keep making loans.' "

Other ailments with fancy-sounding labels fueled this compulsion by infecting earnings. "Disintermediation"—epitomized by the shift among big corporate borrowers from bank loans to the commercial paper market—began in the 1970s. But it exploded in the 1980s. So did "securitization"—the packaging and sale, mainly by investment banks, of loans that were once the exclusive preserve of banks, such as mortgages, car loans, and credit card receivables. While banks could still originate these loans, securitization eliminated profits gained from holding them and earning interest over many years.

WITH THEIR EARNINGS declining, banks have responded much as the S&Ls did, by making riskier loans for which they can collect higher fees and interest. In particular they have poured money into commercial real estate and highly leveraged companies. Last year for the first time *ever* in the U.S., real estate loans alone exceeded the banks' commercial and industrial lending. Unfortunately, what bankers are also discovering—just as they did in the early 1980s after their disastrous lending spree in the Third World—is that in an economic downturn, such loans go bad far more quickly and in far greater numbers than the more conventional variety.

So far banking's woes haven't directly cost U.S. taxpayers a penny. The money that flows into the insurance fund comes from premiums paid by the 13,000 FDIC member banks. Despite the warnings from the General Accounting Office and the Congressional Budget Office, Seidman of the FDIC believes that can continue. "We don't see failures sufficient to imperil our fund," he says. "But that obviously depends on the economic environment." And what is Seidman's best guess about that environment? "We're assuming that it remains about what it is now."

That's also still FORTUNE's assumption (see Fortune Forecast). But to find out what might happen if the economy worsens we enlisted the help of Ferguson & Co., a well-regarded bank consulting firm in Washington, D.C. It built a model that predicts how much equity capital U.S. banks are likely to lose under two scenarios—one in which the economy merely slows further from its current sluggish pace and another in which the U.S. slides into a severe recession. The results suggest that the folks at the GAO and CBO are right to worry.

Ferguson's model assigns a set of values to four key factors that reduce bank capital. For example, in the "slowdown" scenario, it assumes 30% of loans already on banks' books as nonperforming loans would go uncollected, whereas in the "recession" case, it as-

REPORTER ASSOCIATES *Jessica Skelly von Brachel, John Labate, and Jennifer Reese*

sumes 50% must be written off. Such losses are then partly offset by the banks' compensating earnings power and various accounting complexities, such as the tax credits generated by the losses. In the less dire scenario Ferguson assumes that the average bank earns a return equal to 0.75% of its assets, while the severe scenario lowers that return to 0.50%. All these assumptions are drawn from close analysis of earlier banking disasters.

Other banking experts consulted by FORTUNE agree that as a stress test, Ferguson's model is reasonable. It is also conservatively based on the most recent publicly available FDIC data. Because these date back to March 31, they understate the recent deterioration in many banks' real estate loan portfolios, particularly in hard-hit regions such as New England.

So what's the potential damage? Under the slowdown scenario, the entire U.S. banking system suffers a net loss of some $19.5 billion in equity capital. David Cates, Ferguson's chairman and the model's creator, figures that would translate into a $5 billion hit to the FDIC's insurance fund. A loss that big, in turn, would give rise to further trouble. "Once the fund slips into single digits [below $10 billion]," says Cates, "it risks becoming effectively insolvent. That's because as it dwindles, big uninsured depositors [the FDIC only insures accounts up to $100,000] will become alarmed and move their money from weaker banks into either strong banks or T-bills." Such a flight from weak banks could trigger failures and a corresponding drain on the fund. To forestall such a run, Cates estimates that taxpayers might be asked to pony up $5 billion to replenish the FDIC's coffers.

In the recession scenario, the banks' equity capital shrinks by $86.3 billion—a far more worrisome 41% cut in the system's capital cushion. But healthy banks would absorb part of the capital loss, Cates figures, and the FDIC could tap them for higher premiums. Taxpayers, he calculates, would be left facing a maximum bill of $40 billion.

That's some $100 billion less than even the most conservative estimates of the potential cost of the S&L bailout—good news if you're the type who insists on always looking at the half-full side of the glass. There's also comfort, though of a distinctly chilly sort, in Cates's finding that most big banks with the heaviest exposure to high-risk loans would survive a really nasty recession (see box).

STILL, A POTENTIAL taxpayer liability of $40 billion is hardly chicken feed. And compared with the thrifts, banks play a far more critical role in the economy. That's why it's essential that legislators and regulators shore up their safety and soundness with greater skill and alacrity than they have displayed in the S&L debacle.

At the moment Congress is eagerly awaiting a Treasury Department study on bank reform that's meant to provide a foundation for new legislation from the Bush Administration. But that study is not due until December. In the meantime, here are FORTUNE's reform proposals, drawn from extensive interviews with industry experts:

■ **Intervene earlier.** Banking regulators lack the kind of clearly defined early warning policy that the SEC uses to police Wall Street. As a result they often step in *after* banks are too far gone to save. Lowell Bryan, the top banking consultant at McKinsey & Co., would like the government to draw up a well-defined system of green, yellow, and red light signals that could help both banks and regulators determine when an institution is veering off course.

Here's an example. Richard Randall, a vice president of the Federal Reserve Bank of Boston, points out that as early as 1986, some medium-size New England banks had made loans to builders that amounted to more than 20% of their entire portfolios. In one extreme case, a bank's construction loans amounted to 70% of total loans—a clear signal to call in the cops.

■ **Improve bank accounting.** Today banks mask the true health of their balance sheets in a number of ways. For one thing, they can carry loans on their balance sheets at historical value—even if their value later deteriorates. This practice creates a huge incentive

HOW TOUGH TIMES COULD HIT BIG BANKS

Of the top 40 U.S. banks, the ten listed here have the lowest ratio of loss reserves and equity to high-risk assets—a category that includes LDC debt, real estate lending, and "highly leveraged transaction" loans. The numbers shown below reflect FDIC data, which cover only the operations of the companies' banking subsidiaries and thus may differ from their consolidated financial reports.

To examine how this group could fare if times get tougher, FORTUNE asked Ferguson & Co., a leading bank consulting firm, to put their numbers through its "stress test." This model, described in detail starting on page 120, assumes the economy goes into either a downturn or a bad recession.

In a slowdown, most suffer hefty hits to equity capital. But none, even ailing Bank of New England (BNE), would be hurt so badly that insolvency is a certainty. In a sharp recession, however, the model predicts that BNE would fail and even banks outside New England would take a vicious pounding, ranging from a loss of 74% of equity capital at Citicorp to 37% at First Union.

BANK All figures in millions	ASSETS	EQUITY CAPITAL		
		Current*	Slowdown	Recession
Citicorp	$198,546	$11,056	$8,468	$2,893
Chase Manhattan	$103,343	$5,075	$5,120	$2,478
Chemical	$74,483	$3,851	$4,257	$2,399
Manufacturers Hanover	$55,555	$2,850	$3,221	$1,616
Wells Fargo	$47,016	$3,202	$2,605	$1,491
First Union	$40,225	$2,704	$2,385	$1,690
Bank of Boston	$37,356	$1,906	$1,647	$617
Barnett Banks	$29,397	$1,634	$1,256	$651
Bank of New England	$26,731	$626	$659	-$495
Southeast Banking	$16,729	$744	$626	$274

*Based on FDIC data as of March 31, 1990.

SOURCE: FERGUSON & CO.

for lenders to roll the dice.

To remove that incentive, banks should be forced to do what regulators do only after they move in to liquidate—mark loans and investments to market wherever possible. Where no liquid market exists for an asset, as in the case of nonperforming loans, then some proxy for what that loan realistically should be earning—the prime rate plus a few points, say—should be used to discount its value.

■ Raise deposit insurance premiums. Since its inception in 1933, deposit insurance has proved wonderfully effective in maintaining investor confidence. Its huge drawback, however, is that it enables bankers to make gamier loans than they would if the government were not there to bail out depositors. In 1980, the same year that Reg Q was axed, Congress made that drawback worse by raising the limit on insured accounts from $40,000 to $100,000.

"You want banking insured," says Charles Munger of Berkshire Hathaway. "Bank panics are for the birds."

But current proposals to solve this problem by returning to the $40,000 ceiling or limiting insured accounts to one for each individual miss the point: The real exposure taxpayers face is the *uninsured* deposits of large corporations and pension funds. Under the "too big to fail doctrine"—last seen at work in the 1984 bailout of Continental Illinois—the Federal Reserve and other bank regulators have rightly served notice by word and deed that they would not allow large banks with vast numbers of such depositors to fail. The damage to the banking system from the stampede that would ensue as these depositors scrambled for safety would be too great. Says Charles Munger, the vice chairman of Berkshire Hathaway: "You want banking insured. Bank panics are for the birds."

Instead, Washington would do well to adopt a two-step reform. First, it should stitch up the existing safety net by raising the insurance premiums that banks pay. Seidman of the FDIC has already proposed boosting them from 12 cents for every $100 of insured deposits to 19.5 cents—the maximum allowed by law. That would raise some $5 billion for the insurance fund. Congress should also follow Fed Chairman Alan Greenspan's recent advice and grant the FDIC new authority to go higher if necessary.

Individual depositors, of course, will share the cost of higher premiums, either through higher fees for services or lower interest rates on deposits. They should. They've been getting too good a deal on deposit insurance for too long.

■ Limit insurance to supersafe banks. Once banking's insurance safety net has been made more secure, it must then be cut back so that it covers only low-risk lending. McKinsey's Lowell Bryan calls this establishing "core banks." To remain insured by the FDIC, such banks would abide by strict

"Yeah, I'd say my future here looks great. They like my work. I got a promotion. I've got great benefits..."

"But let's face it: Jobs don't come with a lifetime guarantee anymore."

limits on how they operate. For example, they might be allowed to lend only to individuals, small businesses, and midsize companies and to invest only in government securities.

At the same time Congress should create separate *uninsured* banks that would be free to engage in riskier activities, such as real estate or overseas lending. These banks would also be allowed to enter other long-forbidden financial service businesses like investment banking and insurance, as long as they met those industries' regulatory and disclosure standards. Such institutions would most resemble companies like American Express, General Electric Credit, and Ford Motor Credit. If they emulate this crowd's fine track record, these new banks should have little trouble attracting capital from investors. But under this arrangement, those seeking higher than average returns on deposits would be the ones exposed to any market risk—not U.S. taxpayers.

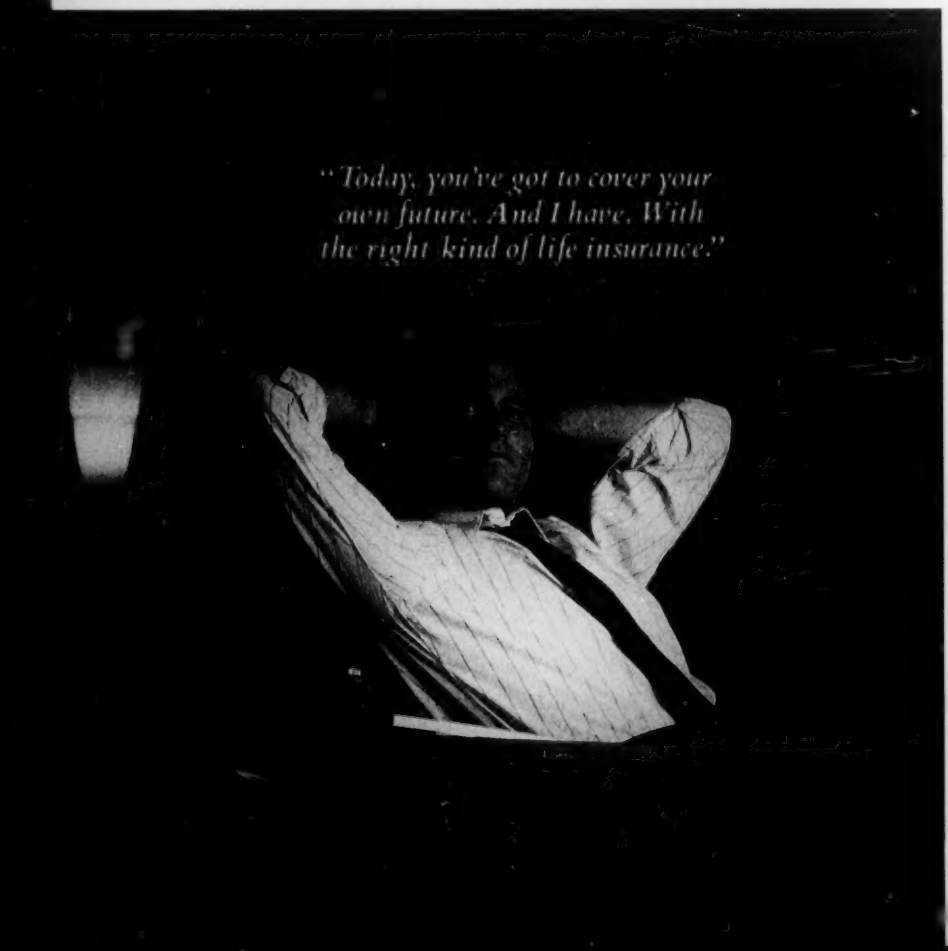
RICHARD HOWARD

This condo near Boston is a Bank of New England loan gone bad.

Finding a way to limit deposit insurance to a narrower version of banking ought to be the keystone of any comprehensive reform. But while this notion has been gaining support, it's still not clear that the White House and Congress will move swiftly enough to avert a crisis. Says Barry Weingast, a senior fellow at Stanford University's Hoover Institution and a close student of the politics of the S&L debacle: "The issue is this: Are our politicians sufficiently chastened or embarrassed by the savings and loan crisis that they will do the responsible thing this time?"

There are grounds to worry that they aren't. For example, the recent reaction of some legislators from New England to that region's banking woes has been distressingly similar to the behavior of their Texas counterparts when the thrifts began to bleed in the mid-1980s. Regulatory forbearance, rather than rigor, is all too often the watchword.

Most citizens, of course, can't be expected to follow the complex ins and outs of banking reform. Therein lies another problem. Observes Stanford's Weingast: "The fundamental flaw we saw in the S&L crisis is that even when politicians understand a problem, unless they feel they can get credit from voters for solving it, they tend to let it unfold." The best way to avoid the fire next time will be if voters at least send Washington a clear message that they will neither forgive nor forget another S&L-style sleepwalk. F



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